93-572

No. _____

Supreme Court, U.S.
FILED
OCT 12 1993
OFFICE OF THE CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1993

FRUEHAUF CORPORATION,

Petitioner,

vs.

C. KENNETH STILL, TRUSTEE
FOR SOUTHWEST EQUIPMENT RENTAL, INC.,
D/B/A SOUTHWEST MOTOR FREIGHT,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Steven E. Schmidt
[Counsel of Record]

William S. Lockett, Jr.
KENNERLY, MONTGOMERY &
FINLEY, P.C.
4th Floor, NationsBank Center
550 Main Avenue
Knoxville, Tennessee 37902
(615) 546-7311

Counsel for Petitioner

BECKER GALLAGHER LEGAL PUBLISHING, INC., CINCINNATI, OHIO (513) 621-2880

QUESTIONS PRESENTED

1. Does the *ordinary business terms* test of 11 U.S.C. § 547(c)(2)(C) relate to ordinary business terms between the parties or to "ordinary business terms" in the industry in question?

2. If the nature of a transaction, and its contractual terms and conditions, are customary and ordinary in the industry in question, does a creditor lose the benefits of 11 U.S.C. § 547(c)(2)(C) simply because it accepts late payments without showing that the making of late payments is a standard practice in the industry?

3. If a creditor does not exert unusual collection efforts, assists the debtor staying in business, and has always accepted late payments, should the 11 U.S.C. § 547(c)(2)(B) *ordinary course of business* defense be lost simply because payments became slightly later during the preference period?

PARTIES

PETITIONER-APPELLANT:

*Fruehauf Corporation

RESPONDENT-APPELLEE

C. Kenneth Still, Trustee for
Southwest Equipment Rental, Inc.,
d/b/a Southwest Motor Freight

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* Fruehauf Trailer Corporation has purchased Fruehauf Corporation's trailer business and assumed Fruehauf Corporation's trailer business liabilities, including any liabilities of Fruehauf Corporation in this case. Fruehauf Trailer Corporation is publicly traded and is a majority owned subsidiary of Terex Corporation, which is publicly traded. Fruehauf Corporation has changed its name to K-H Corporation and is a wholly-owned subsidiary of Varity Corporation, which is publicly traded.

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C. KENNETH STILL, TRUSTEE
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D/B/A SOUTHWEST MOTOR FREIGHT,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Petitioner respectfully requests that a Writ of Certiorari issue to review the judgment and decision of the United States Court of Appeals for the Sixth Circuit entered in this case on July 13, 1993.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Sixth Circuit was not recommended for full-text publication but appears in the appendix. The order of the United States District Court for the Eastern District of Tennessee at Chat-

tanooga, Civil No. 1-90-209, has not been officially reported but is contained in the record (R. 25; Order) (Appendix, p. 50). A copy also appears in the appendix.

The memorandum opinion of the United States Bankruptcy Court for the Eastern District of Tennessee, Southern Division, Case No. 88-00033 Adversary No. 89-0477, has not been officially reported but is contained in the record (Appendix, p. 16). A copy also appears in the appendix.

JURISDICTION

By order dated July 13, 1993, the United States Court of Appeals for the Sixth Circuit affirmed in part and reversed in part the United States District Court for the Eastern District of Tennessee's decision which had held that only three (3) payments made by Southwest Equipment Rental, Inc., to Fruehauf Corporation were avoidable preferential transfers unprotected by the ordinary course of business defense afforded under 11 U.S.C. § 547(c)(2). On August 2, 1993, petitioner Fruehauf Corporation filed its Motion for Stay of the Issuance of a Mandate in this case. On August 9, 1992 the Sixth Circuit denied Fruehauf's Motion for Stay, and on August 10, 1992 the Mandate was issued. On August 24, 1992 the District Court entered its Order pursuant to the Mandate. This Petition for Certiorari was filed within ninety (90) days of the entry of the per curiam decision of the United States Court of Appeals for the Sixth Circuit. This court's jurisdiction is invoked under 28 U.S.C. § 1254(l).

STATUTORY PROVISIONS INVOLVED

1. 11 U.S.C. § 547(c)(2) which provides as follows:

> (c) The trustee may not avoid under this section a transfer—
>
> (2) to the extent that such transfer was —
>
> (A) in payment of a debt incurred by the debtor in the ordinary course of business or

financial affairs of the debtor and the transferee;

(B) made in the ordinary course of business or financial affairs of the debtor and the transferee; and

(C) made according to ordinary business terms.

STATEMENT OF THE CASE

Southwest Equipment Rental, Inc., d/b/a Southwest Motor Freight ("Southwest"), a trucking corporation hauling goods in interstate commerce, and Fruehauf Corporation ("Fruehauf"), a corporation engaged (among other things) in the business of buying, selling and leasing truck trailers, entered into a master lease with four supplements each covering one hundred truck trailers on or about July 30, 1986 (the "Lease"). The United States Bankruptcy Court for the Eastern District of Tennessee, Southern Division ("Bankruptcy Court"), the United States District Court for the Eastern District of Tennessee at Chattanooga ("District Court") and the United States Court of Appeals for the Sixth Circuit ("Sixth Circuit") all determined that the Lease was a "true lease". Under the terms of the Lease, Southwest was to pay monthly rental to Freuhauf for the trailers in the amount of Two Hundred Twenty-Five and 13/100 Dollars ($225.13) for each trailer per month.

Because the monthly lease payments had been reduced to permit Fruehauf to receive and expect an investment tax credit, the Lease had a provision that if the investment tax credit became unavailable during the term, the lease payments would be increased accordingly. When the tax laws were changed following execution of the Lease and Fruehauf increased the monthly lease payments, a dispute between the parties arose. To resolve these differences, the Lease was ter-

minated and an installment sales contract was entered into between the parties on May 5, 1987.

While the Lease was in effect, Southwest made forty-seven (47) lease payments to Fruehauf, seven (7) of which were made more than one (1) year prior to Southwest's filing of its bankruptcy petition, and forty (40) of which were made within one (1) year of Southwest's filing of such petition. All of the payments from Southwest to Fruehauf, whether before or during the one-year preference period, were late. Being delinquent in the making of its payments was how Southwest conducted its business during this period. The record reflects that nearly every payment Southwest made on any of its obligations while the Lease was in effect were made over thirty (30) days late.

The payments from Southwest to Fruehauf were at all times irregular, varying both in amount and in the number of days late from the due date in which they were paid. The payment amounts varied from $4,502.60 to $22,513.00, and the payments varied in terms of the number of days late after the due date from four to sixty-eight days late. The lease payments prior to the preference period were made between five and thirty-one days late, and the lease payments made during the preference period were from four to sixty-eight days late. Various witnesses testified that late payments occurred in the common carrier industry and that between two and twenty percent (depending on the witness) of all payments made on trailer leases they were familiar with were between thirty and sixty days late.

On January 8, 1988, Southwest filed a Chapter 11 bankruptcy petition which was, on March 8, 1988, converted to a Chapter 7 case. On December 21, 1989, Southwest's trustee, C. Kenneth Still ("Trustee"), filed a complaint in the Bankruptcy Court claiming that Fruehauf should return all forty payments made pursuant to the Lease during the one-year preference period. The one-year period rather than a ninety-day period for preference recovery was upheld by all

of the lower courts due to the fact that Fruehauf received the personal guaranty of the President of Southwest in connection with the lease payments.

All of the lower courts found that Fruehauf was entitled to new value credits pursuant to 11 U.S.C. § 547(c)(4). The lower courts have differed, however, as to which of the forty payments during the preference period were subject to the ordinary course of business exception to preference avoidance provided under 11 U.S.C. § 547(c)(2). Although it was undisputed that all of the lease payments were "in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of debtor and the transferee" [11 U.S.C. § 547(c)(2)(A)], the lower courts have not agreed as to which of such payments were "made in the ordinary course of business or financial affairs of the debtor and the transferee" [11 U.S.C. § 547(c)(2)(B)] and which were "made according to ordinary business terms" [11 U.S.C. § 547(c)(2)(C)].

The Bankruptcy Court, relying primarily on *Carlson* v. *Hughes (In re Aldridge)*, 94 B.R. 589 (Bankr. W.D. Mo. 1988), *Jensen* v. *Raymond Bldg. Supply Corp. (In re Homes of Port Charlotte)*, 109 B.R. 489 (Bankr. M.D. Fla. 1990), *Global Distrib. Network* v. *Star Expansion Co. (In re Global Distrib. Network)*, 103 B.R. 949 (Bankr. N.D. Ill. 1989), *Marathon Oil Co.* v. *Flatau (In re Craig Oil Co.)*, 785 F.2d 1563 (11th Cir. 1986), and *Ewald Bros., Inc.* v. *Kraft, Inc. (In re Ewald Bros., Inc.)*, 45 B.R. 52 (Bankr. D. Minn. 1984), found that lease payments made within the preference period which were over thirty days late were not made in the ordinary course of business of Southwest and Fruehauf or according to ordinary terms and were therefore avoidable as preferences, and that only those payments made thirty days late or less were consistent with the party's prior course of dealings and according to ordinary business terms and therefore protected by the 11 U.S.C. § 547(c)(2) exception.

The District Court, relying primarily on *In re Fulghum Const. Corp.*, 872 F.2d 739 (6th Cir. 1989) and *In re Yurika*

Foods Corp., 888 F.2d 42 (6th Cir. 1989), and the cases cited in those decisions, found that Fruehauf's continuing to accept late payments when Southwest was clearly in financial difficulty was within the ordinary course of business exception even though some of such payments were later than had been the custom prior to the beginning of the preference period. Instead, the District Court found that only three payments made during April of 1987, which were made on an unusually timely basis due to unusual action taken by Fruehauf to require more timely payments than it had in the past, should not be the subject of the ordinary course of business exception.

The Sixth Circuit, placing its primary reliance on the case of *Logan* v. *Basic Distribution Corp. (In re Fred Hawes Organization, Inc.)*, 957 F.2d 239 (6th Cir. 1992), concluded that the Bankruptcy Court was correct in finding that payments over thirty days late were not made in accordance with standard industry practices and that, as a result, the District Court should be reversed in its holding that only the three remarkably prompt payments made in response to Fruehauf's unusual collection efforts were avoidable preferences.

REASONS FOR GRANTING THE PETITION

THE DECISION BELOW RAISES IMPORTANT QUESTIONS OF FEDERAL LAW WHICH SIGNIFICANTLY IMPACT ON THE GOALS OF 11 U.S.C. §547(C)(2) FOR PROTECTING RECURRING, CUSTOMARY CREDIT TRANSACTIONS WHICH CONGRESS INTENDED WHEN IT ENACTED THE BANKRUPTCY CODE AND SUCH QUESTIONS HAVE NOT BEEN, BUT SHOULD BE, SETTLED BY THIS COURT.

In reversing the decision of the District Court in this case, the Sixth Circuit ruled that the examination under 11 U.S.C. § 547(c)(2)(C) as to whether a transaction complies with "ordinary business terms" was to focus on "ordinary business terms in the industry" rather than "ordinary business terms between the parties". In doing so, the Sixth Circuit relied on its recent decision of *Logan* v. *Basic Distribution Corp. (In re Fred Hawes Organization, Inc.)*, 957 F.2d 239 (6th Cir. 1992), which had in turn relied upon a trio of bankruptcy court decisions. *See In re SPW Corp.*, 96 B.R. 683 (Bankr. N.D. Tex. 1989); *In re Unimet Corp.*, 85 B.R. 450 (Bankr. W.D. Ohio 1988); *In re Steel Improv. Co.*, 79 B.R. 681 (Bankr. E.D. Mich. 1987).

The District Court in this case had ruled that this third prong of the "ordinary course of business defense" was to be directed to what were the "ordinary business terms between the parties" as opposed to what were the "ordinary business terms in the industry". In this regard, the District Court had relied upon the previous decisions of the Sixth Circuit in *In re Fulghum Constr. Corp.*, 872 F.2d 739 (6th Cir. 1989) and *In re Yurika Foods Corp.*, 888 F.2d 42 (6th Cir. 1989), and upon numerous prior bankruptcy court decisions. *See Ewald Bros., Inc.* v. *Kraft, Inc., (In re Ewald Bros., Inc.)*, 45 B.R. 52 (Bankr. D. Minn. 1984); *In re Sunup/Sundown, Inc.*, 66 B.R. 1021 (Bkrtcy. S.D. Fla. 1986); *Newton* v. *Ed's Supply Co., Inc. (In re White)*, 58 B.R. 266 (Bkrtcy. E.D. Tenn. 1986); *In*

re Jerry-Sue Fashions, Inc., 91 B.R. 1006 (Bkrtcy. S.D. Fla. 1988); *In re Gardner Matthews Plantation Co.*, 118 B.R. 384 (Bkrtcy. D.S.C. 1989); *In re Mindy's, Inc.*, 17 B.R. 177 (Bkrtcy. S.D. Ohio 1982); *In re Decor Noel Corp.*, 65 B.R. 707 (Bkrtcy. W.D. Tenn. 1985); *In re First Software Corp.*, 81 B.R. 211 (Bkrtcy. D. Mass. 1988); *In re Ferguson*, 41 B.R. 118 (Bkrtcy. E.D. Va. 1984).

As can be seen from all of these cases, this issue of whether the "ordinary business terms" test of 11 U.S.C. § 547(c)(2)(C) refers to "ordinary business terms between the parties" or to "ordinary business terms in the industry" has been a fertile ground of contention among numerous litigants all over the country. It clearly is an important question of federal law which has not been, but should be, settled by this Court. There is a split of authority among the lower federal courts and bankruptcy courts on this issue, and the case presents this Court with an opportunity to resolve this question once and for all.

In addition, even if it were to be determined that 11 U.S.C. § 547(c)(2)(C) relates to "ordinary business terms in the industry", the inquiry does not end there. The question remains whether the focus of this inquiry should be upon (1) "were the terms employed in and governing the transaction as a whole" customary business terms or (2) whether the "practice of making late payments is an 'industry standard' practice". Those issues have likewise been the subject of conflicting decisions by the bankruptcy courts and lower federal courts. The Sixth Circuit in this case determined that since the petitioner Fruehauf had not established to the Bankruptcy Court's satisfaction that the making of payments more than thirty days late was an "industry standard practice", it was compelled to rule that the "ordinary business terms" test has not been satisifed. Numerous other decisions establish, however, that the inquiry concerning whether the "ordinary business terms" test was satisfied should instead focus on the nature of the transaction, and its contractual terms and conditions, as a whole. *See e.g., In re Magic Circle Energy*

Corp., 64 B.R. 269 (Bkrtcy. W.D. Okla. 1986); *In re Production Steel, Inc.*, 54 B.R. 417 (Bkrtcy. M.D. Tenn. 1985); *Newton* v. *Andrews Distrib. Co. (In re White)*, 64 B.R. 843 (Bkrtcy. E.D. Tenn. 1986); *In re Ferguson*, 41 B.R. 118 (Bkrtcy. E.D. Va. 1984); *In re Fulghum Constr. Corp., supra.*

The *In re Magic Circle Energy Corp.* court, for example, in discussing whether the "ordinary business terms" exception was met, noted "[t]he issue is whether the workout and the long-term installment note, 'when taken together, *constitute a transaction* made according to ordinary business terms.' " *In re Magic Circle Energy Corp.* at p. 275, citing *In re Production Steel, Inc.* at p. 424 (emphasis added). The *In re Magic Circle Energy Corp.* court took judicial notice of the fact "that a workout which contemplated a promissory note at eight percent per annum payable in monthly installments over a period of seven years was well within 'ordinary business terms' " (*In re Magic Circle Energy Corp.* at p. 275) in the oil and gas industry at that time, making it clear that it was concerned with whether the "transaction as a whole", as opposed to the physical making of payments in connection with that transaction, was an ordinary one in the industry containing terms for business relationships within the norm of the industry.

Similarly, the *In re Production Steel, Inc.* court indicated that requirements in a transaction for down payments, letters of credit, premature requests for payment and payments by post-dated check must be analyzed as a whole to determine whether the same "*constitute a transaction* made according to ordinary business terms." *In re Production Steel, Inc.*, p. 424 (emphasis added).

To focus, as did the Sixth Circuit and the cases it relied upon, simply upon whether late payments are a standard practice in the industry destroys the objectives of 11 U.S.C. § 547(c)(2) which are (i) to encourage "short term credit dealing[s] with troubled debtors in order to forestall bankruptcy"

(*Fulghum*, p. 744, citing *In re First Software Corp.*, 81 B.R. 211 (Bkrtcy. D. Mass. 1988) and (ii) to encourage "creditors to conduct business with a struggling enterprise so that debtors can rehabilitate themselves". *In re Fulghum Constr. Corp.*, p. 744, citing *O'Neil* v. *Nestle Libbys P.R., Inc.*, 729 F.2d 35 (1st Cir. 1984). A creditor can hardly be encouraged to work with a debtor and give the relief of a little more time to make his payments, and thereby assist the debtor to remain in business and have a chance of repaying its other creditors, if there is a rigid standard that the permitting of late payments will result in a loss of the exception to preference avoidance provided by 11 U.S.C. § 547(c)(2). Instead, such a standard encourages creditors to sue for their payments immediately upon any delinquency, for only then can they be assured they will not have to return a subsequently collected payment as a preference. Furthermore, it is difficult to imagine that anyone will ever be able to prove that it is a standard practice of any industry to permit late payments as an ordinary and customary practice.

As a result, this case presents this Court with the opportunity to finally decide if the ordinary business terms exception of 11 U.S.C. § 547(c)(2)(C) relates to whether the transaction and its contractual terms, taken as a whole, comport with industry standards or if the inquiry is to be simply whether the physical making of late payments is an industry standard practice. This is an important question of federal law which should be resolved.

A third question presented by this case, the determination of which has a significant impact on the fulfilling of the objectives of 11 U.S.C. § 547(c)(2), is whether a creditor which has not exerted unusual collection efforts, and has assisted the debtor in staying in business by continuing to accept late payments, should lose the "ordinary course of business" defense simply because payments became slightly later during the preference period. Again, this question has been the subject of conflicting decisions among bankruptcy and other lower federal courts.

The objectives of the "ordinary course of business" defense (i.e., encouraging creditors to conduct business with a struggling enterprise so that the debtors can rehabilitate themselves, and encouraging short-term credit dealings with troubled debtors in order to forestall bankruptcy rather than encourage it) have been determined by numerous bankruptcy and lower federal courts to be best served by focusing on "whether or not the creditor took some unusual action to require a debtor to make payments on a more timely basis during the preference period than was required before it so that the creditor would obtain more favorable treatment from the insolvent debtor than other creditors." District Court decision at p. 11. In examining this issue, the District Court determined that the fact petitioner Fruehauf continued to accept late payments when Southwest was clearly in financial difficulty should help rather than hurt Fruehauf in its "ordinary course of business" defense to preference avoidance.

This analysis has likewise been adopted by the Seventh Circuit in the case of *In re Colonial Discount Corp.*, 807 F.2d 594 (7th Cir. 1986). In finding that the creditor in that case who made short-term loans to a debtor on the eve of bankruptcy should not lose this defense, the Seventh Circuit noted: "[n]othing in the record suggests that the Silverton loan transaction was related in any way to pre-bankruptcy planning. . . . Nor does it indicate any 'unusual action by either the debtor or creditor' to collect or pay on the deal." *Id.* at p. 600, citing *Barash* v. *Public Fin. Corp.*, 658 F.2d 504 (7th Cir. 1981).

Other cases which have held that the purpose of 11 U.S.C. § 547(c)(2) was to protect payments which do not result from unusual debt collection practices are *In re Magic Circle Energy Corp.*, *supra* ("The purpose of a preference action is to prevent a particular creditor from obtaining *more favorable treatment than other creditors.*" *Id.* at p. 275) (emphasis added); *In re Production Steel, Inc.*, *supra*; *Morris* v. *United States (In re Morris)*, 53 B.R. 190 (Bkrtcy. Or. 1985).

The Bankruptcy Court and the Sixth Circuit ignored this reasoning and instead focused solely on whether payments made during the preference period were any later than they had been prior to the preference period. Although other bankruptcy and lower federal courts likewise have focused on this issue (*See Carlson* v. *Hughes (In re Aldridge)*, 94 B.R. 589 (Bkrtcy. W.D. Mo. 1988); *Jensen* v. *Raymond Bldg. Supply Corp. (In re Homes of Port Charlotte)*, 109 B.R. 489 (Bkrtcy. M.D. Fla. 1990); *Global Distrib. Network* v. *Star Expansion Co. (In re Global Distrib. Network)*, 103 B.R. 949 (Bankr. M.D. Ill. 1989)), the Seventh Circuit has pointed out the fallacy of this approach in the case of *Matter of Xonics Imaging, Inc.*, 837 F.2d 763 (7th Cir. 1988), noting that to find an avoidable preference where there had been a history of late payments only because the creditor allowed the payments to be made slightly later than before would "hardly be a case within the policy of section 547(b), since it would not be a case where the tottering debtor had decided to put one creditor ahead of the others; he would simply be doing the same thing he had been doing before he began to totter." *Id.* at p. 767.

As a result, this case presents this Court with the opportunity to finally resolve the significant federal question of whether the focus of the "ordinary business terms" defense should be on whether a creditor had employed debt collection practices or other activities designed to place it in a more favorable position than other creditors, or to focus simply and woodenly on whether the payments in question became slightly later during the preference period than they had been before. Bankruptcy and other federal courts have differed in their analysis of this issue, which goes to the heart of the purposes and objectives of 11 U.S.C. § 547(c)(2). This matter should, therefore, be resolved by this Court.

CONCLUSION

The three questions presented by this case are important federal questions which have not been, but should be, settled by this Court. Decisions of lower federal courts and bankruptcy courts are in conflict over the manner in which such questions should be decided. Whether the previously enunciated objectives and purposes of 11 U.S.C. § 547(c)(2) as originally contemplated will be furthered, or whether such goals will be limited by a judicial gloss that makes the timing of payments an overriding and seemingly unconquerable obstacle to achieving the benefits of the "ordinary course of business" defense, is a matter which requires this Court's guidance to resolve.

These questions are of significant importance to businesses and individuals throughout the nation and need to be resolved to provide a sense of predictability and stability to debtor/creditor relations. Creditors who are inclined to work with their debtors to help avoid the need to seek bankruptcy protection are being punished in some jurisdictions and rewarded in others for the same conduct under the same statute. This creates a highly unsatisfactory and unnecessary dilemma for creditors who are being asked to provide some relief to customers experiencing financial difficulties. This case presents this Court with the opportunity to set forth uniform standards and relieve current uncertainties in this frequently visited and litigated arena.

For all of the foregoing reasons petitioner respectfully requests that this Petition be granted and that this Court issue a writ of certiorari to the United States Court of Appeals for the Sixth Circuit.

Respectfully submitted,

KENNERLY, MONTGOMERY &
FINLEY, P.C.

By _____

Steven E. Schmidt
[Counsel of Record]

William S. Lockett, Jr.
4th Floor, NationsBank Center
550 Main Avenue
Knoxville, Tennessee 37902
(615) 546-7311

Appendix

NOT FOR PUBLICATION

NOT RECOMMEDED FOR FULL-TEXT PUBLICATION
Sixth Circuit Rule 24 limits citation to specific situations. Please see Rule 24 before citing in a proceeding in a court in the Sixth Circuit. If cited, a copy must be served on other parties and the Court. This section is to be *prominently* displayed if this decision is reproduced.

92-5848

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

C. KENNETH STILL,
Plaintiff-Appellant,

v.

FRUEHAUF CORP.,
Defendant-Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF TENNESSEE

BEFORE: KEITH and NELSON, Circuit Judges; CELEBREZZE, Senior Circuit Judge.

PER CURIAM: Plaintiff-Appellant, C. Kenneth Still ("Still"), appeals the district court's order affirming, in part, the bankruptcy court's denial of his claim to recover lease payments as preferential transfers under 11 U.S.C. § 547(b) of the Bankruptcy Code. For the reasons stated below, we **AFFIRM** in part and **REVERSE** in part the decision of the district court.

I.

This case involves a claim originally filed by C. Kenneth Still, as trustee for Southwest Equipment Rental, Inc. ("Southwest"), against Fruehauf Corporation ("Fruehauf") for the return of forty lease payments made by Southwest to Fruehauf. Still claimed that the payments in question were recoverable as preferential transfers under 11 U.S.C. § 547(b). Fruehauf denied that the payments were preferential transfers, but claimed that the payments were made in the ordinary course of business and, therefore, exempt from preference avoidance under 11 U.S.C. § 547(c)(2).

The relevant facts of this case are not in dispute and are adequately summarized in both the bankruptcy court's memorandum decision and the district court's order. The history of lease payments made by Southwest to Fruehauf during the relevant time period is set forth in the bankruptcy court's memorandum decision. (See Bankruptcy Court Memorandum at 22-23, 25-26).

The case was heard on December 4 and 5, 1990, by the Bankruptcy Court for the Eastern District of Tennessee, Southern Division. The bankruptcy court issued a memorandum decision on March 6, 1991, instructing the parties to submit a judgment to the court in accordance with the court's memorandum decision. On March 27, 1991, a judgment was entered against Fruehauf for an obligation of $168,135.49 plus $16,873.53 interest. On appeal, the district court issued an order on May 12, 1992, affirming all of the findings and rulings of the bankruptcy court, except its determination of which lease payments were preferential transfers under § 547(b). The district court held that only three payments were preferential transfers recoverable by Southwest from Fruehauf. The district court's decision resulted in an amendment of the original judgment entered by the bankruptcy court. The district court entered an amended judgment against Fruehauf for $8,995.72. Still appeals the district court's decision, raising several challenges to the findings and rulings contained in the court's order. These challenges are discussed seriatim below.

II.

Still contends that the district court erred in its finding that only three payments made by Southwest to Fruehauf were not within the ordinary course of business under § 547(c)(2). Both parties agree that from January through June of 1987, Southwest made 40 lease payments to Fruehauf. Still contends that all 40 payments were preferential transfers. Fruehauf, however, claims that the district court was correct in ruling that only three of the 40 payments were preferential transfers under § 547(b). Section 547(b) provides that a trustee may avoid any transfer of property of the debtor:

> **(1) to or for the benefit of a creditor;**
> **(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;**
> **(3) made while the debtor was insolvent;**
> **(4) made —**
>
> **(A) on or within 90 days before the date of the filing of the petition; or**
>
> **(B) between 90 days and one year before the date of the filing of the petition, if such creditor, at the time of such transfer —**
>
> **(i) was an insider; and**
>
> **(ii) had reasonable cause to believe the debtor was insolvent at the time of such transfer; and**
>
> **(5) that enables such creditor to receive more than such creditor would receive if —**
>
> **(A) the case were a case under chapter 7 of this title;**
>
> **(B) the transfer had not been made; and**
>
> **(C) such creditor received payment of such debt to the extent provided by the provisions of this title.**

11 U.S.C. § 547(b) (West 1979) (emphasis added).

The bankruptcy court found that Still proved all the elements of § 547(b) with respect to the 40 payments or transfers made to Fruehauf. The court explained its findings as follows:

> Except for six interest payments, there appears to be no disagreement that § 547(b)(2) has been satisfied in that the lease payments — all late — were for or on account of an antecedent debt owed by the debtor before such transfer was made. Likewise, the plaintiff has satisfied § 547(b)(1) and § 547(b)(4) of the preference elements since all payments made by Southwest to Fruehauf within the one-year period benefitted Thiele, an insider guarantor of the lease obligations.
>
> Section 547(b)(3) requires that in order for a transfer to be preferential it must be made while the debtor is insolvent. . . . The evidence established that at the time the transfers were made, the debtor was insolvent.
>
> Section 547(b)(5) requires that in order for a transfer to be preferential it must enable a creditor to receive more than the creditor would have received in a chapter 7 liquidation and the disputed transfer had not been made. William Thiele received no security interest for his personal guarantee of the lease and Fruehauf is undersecured in an amount exceeding the transfers at issue. There will not be sufficient funds in the estate to pay unsecured creditors. Therefore, each of the lease payments at issue reduced Thiele's potential liability to Fruehauf under the guarantee, and enabled Thiele to receive more than he would have received in a chapter 7 liquidation if the payments had not been made.

(Bankruptcy Court Memorandum at 11-12) (citations and footnotes omitted)

After concluding that Still had successfully proven that the payments at issue were all preferential transfers under § 547(b), the bankruptcy court then considered § 547(c)(2), which provides a defense to the avoidance of preferential transfers. Section 547(c)(2) reads as follows:

(c) The trustee may not avoid under this section a transfer —

(2) to the extent that such transfer was

(A) in payment of a debt incurred in the ordinary course of business or financial affairs of the debtor and the transferee;

(B) made not later than 45 days after such debt was incurred;

(C) made in the ordinary course of business or financial affairs of the debtor and the transferee; and

(D) made according to ordinary business terms;

11 U.S.C. § 547(c)(2) (West 1979) (emphasis added). The bankruptcy court made the following findings regarding the timeliness of the payments made by Southwest to Fruehauf:

> In the instant case, the majority of the lease payments during the preference period were over 31 days late. Although Fruehauf contends these late payments were made within the ordinary course of business, the evidence at trial showed that sometime prior to March 25, 1987 Fruehauf began to pressure Southwest to make timely payments. Fruehauf notified Southwest it expected the payments due through April, 1987 to be made by April 25th, the May payments to be made by May 15, the June payments to be made by June 7, and the July payments to be on time. The April payments were all made prior to April 25, 1987.
>
> Not only were the majority of the lease payments made later during the preferential period than previously, but 17 checks were issued to replace checks returned for insufficient funds and another five checks never cleared the bank.

(Bankruptcy Court Memorandum at 24-25). In deciding which payments to Fruehauf were made within the ordinary

course of business, the bankruptcy court examined trucking industry practices, stating:

> The proof at trial also demonstrated that while it is ordinary in the trucking industry for common carrier accounts to run one to 30 days past due, it is not ordinary for these accounts to run between 30 and 60 days past due. In fact, the defendant's expert, John Morrow, testified he became involved with the Southwest account because of the seriousness of its delinquency.
>
> The court concludes the lease payments made within the preference period which were over 30 days late or which were made by checks returned for insufficient funds were not made according to the ordinary course of business of Southwest and Fruehauf or according to ordinary business terms. Those payments made 30 days late or less were made consistent with the parties' prior course of dealings and according to ordinary business terms and, thus, fall within the § 547(c)(2) exception.

(Bankruptcy Court Memorandum at 26) (footnote omitted).

The district court overruled the bankruptcy court's determination that payments made to Fruehauf by Southwest more than 30 days late were outside the ordinary course of business. The district Court concluded that only three payments were made to Fruehauf outside the ordinary course of business. The court explained its ruling as follows:

> There is nothing in the facts of this case which suggests that an examination of industry practices was warranted. *See In re Yurika Foods Corp.*, at 45. Without that testimony, there is very little reason to select a 30-day period to determine which payments fall outside the protection of the "ordinary course of business" defense. In addition, there is no evidence that Fruehauf made any effort to declare the lease in

> default or protect its position vis-a-vis other creditors before March of 1987, when Fruehauf first began to pressure Southwest to make more timely payments. When the Court focusses [sic] entirely on the payment pattern established between the parties, three payments made in April of 1987 stand out from all the rest by being only 4, 5, and 8 days overdue. It is only these three remarkably prompt payments which contrast with the gradually more delinquent pattern of business dealings between the parties and suggest that, by that time, Fruehauf was indeed changing its collection practice to better its position.

(District Court Order at 12). Fruehauf contends that the district court's ruling is supported by *In re Yurika Foods Corp.*, 888 F.2d 42 (6th Cir. 1989), and *In re Fulghum*, 872 F.2d 739 (6th Cir. 1989). Still, however, submits that the bankruptcy court's consideration of industry practices is supported by this Circuit's recent decision in *Logan* v. *Basic Distribution Corp. (In re Fred Hawes Organization, Inc.)*, 957 F.2d 239 (6th Cir. 1992). There is a dispute between Still and Fruehauf regarding the *Logan* Court's consideration of industry practices under § 547(c)(2)(C). Fruehauf argues that *Logan* departs from this Court's earlier decisions in *Yurika* and *Fulghum*, while Still argues that *Logan* is consistent with *Yurika* and *Fulghum*.

We do not read *Logan* as departing from this Court's decisions in *Yurkia* and *Fulghum*. Under § 547(c)(2)(B) and (C), as the *Logan* Court noted, a trustee in bankruptcy may not avoid a preferential transfer to the extent that the transfer is shown to have been:

> (A) in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee;
>
> (B) made in the ordinary course of business . . . of the debtor and the transferee; *and*
>
> (C) made according to ordinary business terms.

Logan, 957 F.2d at 243 (emphasis in original).

The *Logan* Court made it clear that each of the above elements must be established if avoidance is to be defeated. Addressing the difference between subsections (B) and (C), the Court stated:

> In using the conjunctive "and" between subsections (B) and (C) — rather than the disjunctive "or" — Congress clearly intended to establish separate, discrete, and independent requirements which a creditor would have to fulfill to prevent avoidance.

Id. at 243-44. Describing the components of subsections (B) and (C) as "subjective" and "objective" respectively, we held in *Logan* that:

> The subjective prong (subsection (B)) requires proof that the debt and its payment are ordinary in relation to other business dealings between *that* creditor and *that* debtor. The objective prong (subsection (C)) requires proof that the payment is ordinary in relation to the standards prevailing in the relevant industry.

Id. at 244 (emphasis in original). This holding is entirely consistent with the approach followed in *Yurika*. There, noting that "industry practices are directly implicated," we tested the payments at issue against both the ordinary course of dealings between the parties and the ordinary practices in the industry as a whole. *Yurika*, 888 F.2d at 45.

As the *Yurika* Court observed, "[t]he *Fulghum* court did acknowledge that courts 'might' be required to examine the industry standards in addition to the parties' prior dealings." *Id.* In fact, the *Fulghum* Court stated that [c]onsideration of the practices of the parties might not conclude the § 547(c)(2) analysis; industry practice might be relevant to the § 547(c)(2)(C) element of 'ordinary business terms.' " *Fulghum*, 872 F.2d at 743, n.5. The *Fulghum* Court went on to note that there was no record evidence to indicate that industry practice differed from the practice of the parties and

that the record disclosed, in at least one respect, that what the parties were doing was a "common practice." *Id.* In *Fulghum*, moreover, the parties were in agreement that " 'ordinary' contemplates what is ordinary with respect to the parties." *Id.* Thus, it seems that the issue decided in *Logan* was simply not presented for decision in *Fulghum*.

For the reasons stated above, we do not read *Logan* as departing from either *Yurika* or *Fulghum*. Accordingly, we reverse the district court's decision overruling the bankruptcy court's findings as to which lease payments were avoidable under § 547(c)(2)(C).

III.

Relying on the Supreme Court's recent decision in *Barnhill* v. *Johnson*, ____ U.S. ____, 112 S. Ct. 1386 (1992), Still contends that the district court erred in affirming the bankruptcy court's decision regarding the date which constitutes a "transfer" under § 547(c)(2). The bankruptcy court held that the dates on which Fruehauf received payments from Southwest, rather than the dates on which the checks cleared Southwest's bank account, are the relevant dates for determining when a "transfer" occurred under § 547(c)(2).

In *Barnhill*, the Court held that under § 547(b) a "transfer" made by check occurs "on the date when the drawee bank honors it" rather than "on the date the check is presented to the recipient." *Barnhill*, 112 S. Ct. at 1388. The *Barnhill* Court specifically distinguished § 547(b) from § 547(c), noting that Courts of Appeals have unanimously held that under § 547(c) a "transfer" is determined based on the date when the payment is delivered. *Id.* at 1391. Noting the different purposes of § 547(c) and § 547(b), the Court refused to adopt the "date of delivery" rule for § 547(b). *Id.* Accordingly, we find no error in the district court's decision affirming the bankruptcy court's ruling that the date on which Fruehauf received checks from Southwest is the date which constitutes a transfer under § 547(c).

IV.

Finally, Still contends that the district court erred in affirming the bankruptcy court's decision that the lease agreement between Southwest and Fruehauf was a true lease and not an installment sales contract. The district court explained that "if the lease were a true lease, the obligation to make the lease payments did not arise until the date the rent was due, and any avoidable lease payments would entitle Fruehauf to credit for 'new value.' " (District Court Order at 4). Fruehauf claims it is entitled to new value credit pursuant to § 547(c)(4), for lease payments avoided by Southwest as preferential transfers under § 547(b).[1]

In *Consumer Lease Network* v. *Puckett (In re Puckett)*, 60 B.R. 223, 235-239 (Bankr. M.D. Tenn. 1986), *aff'd*, 838 F.2d 470 (6th Cir. 1992), the bankruptcy court listed 14 factors that courts often consider in determining when a lease is a true lease. In its memorandum decision, the bankruptcy court listed these factors and applied them to the facts of the present case, noting that "the lease transaction in the instant case contains characteristics typically found in both an installment sales contract and a true lease." (Bankruptcy Court Memorandum at 13-14). The court concluded that the lease

---

[1] Section 547(c)(4) reads as follows:

> *(c) The trustee may not avoid under this section a transfer —*
>
> *(4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor —*
>
> *(A) not secured by an otherwise unavoidable security interest; and*
>
> *(B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor.*

11 U.S.C. § 547(c)(4) (West 1979) (emphasis added). The bankruptcy court found that Fruehauf was entitled to new value credit of $7.40 per day, "since the trailers were being leased at the rates under the long-term lease agreement between Fruehauf and Southwest and not at rates for short-term usage." (Bankruptcy Court Memorandum at 29).

between Southwest and Fruehauf was a true lease, explaining its ruling as follows:

> In the instant case, Southwest was not obligated or "economically compelled" to purchase the trailers at the end of the lease term. The terms of the lease gave Southwest the option to purchase the trailers for fair market value and the evidence indicates the fair market value of the trailers at the conclusion of the lease term would not have been negligible since the trailers would still have had a useful life of three to five years and a residual value of $5,600 per trailer. Although each side can legitimately claim a number of the *Puckett* factors support their respective positions concerning the character of the lease in this case, the fact that the purchase option was not nominal and Southwest was not "economically compelled" to purchase the trailers at the expiration of the lease tips the scales in favor of a conclusion that the lease was a true lease.

(Bankruptcy Court Memorandum at 17-18). The bankruptcy court correctly applied the law and adequately considered the facts in reaching its conclusion that the lease agreement between Southwest and Fruehauf is a true lease and not an installment sales contract. Accordingly, we find no error in the district court's decision affirming the bankruptcy court's ruling.

V.

For the foregoing reasons, we **AFFIRM** in part and **REVERSE** in part, and **REMAND** this case for a judgment to be entered consistent with the bankruptcy court's memorandum decision of March 7, 1991.

ISSUED AS MANDATE 8/10/93
COSTS: No Costs

[DULY CERTIFIED]

UNITED STATES DISTRICT COURT FOR THE
EASTERN DISTRICT OF TENNESSEE
AT CHATTANOOGA

NO. CIV-1-90-209
Adversary Proceeding No. 1-89-477

IN RE: SOUTHWEST EQUIPMENT RENTAL, INC.
d/b/a SOUTHWEST MOTOR FREIGHT

C. KENNETH STILL, Trustee

v.

FRUEHAUF CORPORATION

ORDER
(Filed May 12, 1992)

This case involves a core proceeding under 28 U.S.C. § 157(b)(2)(F), brought by C. Kenneth Still, Trustee for Southwest Equipment Rental, Inc., d/b/a Southwest Motor Freight (Southwest), against the Fruehauf Corporation (Fruehauf) to recover certain allegedly preferential transfers made to Fruehauf within one year of the filing of Southwest's bankruptcy petition on January 8, 1988.

In April of 1986, Southwest, a Chattanooga trucking corporation, contacted Fruehauf, a trailer manufacturing corporation, for the purpose of obtaining new trailers for its fleet. Fruehauf gave Southwest the option to purchase the trailers under an installment sales contract or to lease the trailers under either a terminal rental adjustment clause ("TRAC") lease or an investment tax credit lease. Southwest chose the investment tax credit lease which allowed Southwest to receive lower rental payments as a result of the investment tax credit available to Fruehauf. The lease, executed on July 30, 1986, was comprised of a master lease and four supplements that covered 100 trailers each. It was for a

term of 84 months and all payments were due monthly. William R. Thiele, president of Southwest, personally guaranteed Southwest's payment obligations. This meant that all of Southwest's payments to the outsider, Fruehauf, were also for the benefit of its "insider" guarantor, reducing his exposure to liability.

The lease provided that if the investment tax credit became unavailable, Fruehauf would be able to increase the lease payments accordingly. During the course of the lease, the tax laws were changed, eliminating Fruehauf's investment tax credit. On May 5, 1987, after the parties had been unable to agree on a new rental rate, the lease was converted to a retail installment contract. Right after this conversion, and somehow in connection with it, Southwest made six interest payments in the amount of $7,590.22 each.

In the one year period prior to the filing of its bankruptcy, Southwest made 40 payments pursuant to the lease agreement (10 per 100-trailer sublease) totalling $464,283.16. All of the payments were delinquent, 17 checks were issued to replace checks returned for insufficient funds, and another five checks never cleared the bank. Six of these payments were the interest payments mentioned above.

In bringing this action, the plaintiff Trustee sought to recover the entire $464,283.16 in payments. He contended first that the one year "insider" preference period applied to this case because of Mr. Thiele's personal guarantee of Southwest's lease. He also claimed that the lease agreement between Fruehauf and Southwest was actually a disguised installment sales contract and that all 40 payments made by Southwest were preferential payments on account of the antecedent purchase price debt. In the alternative, the Trustee argued that, if the Court were to conclude that the lease was a true lease, the payments were still preferential because they were all delinquent and not made in the ordinary course of business or as contemporaneous exchanges for new value. Finally, although the Trustee insisted that Fruehauf was not entitled to "new value" credit under § 547(c)(4) because the lease at issue was not a true lease, he

argued that, if the Court found that Fruehauf was entitled to such credit, the amount of this credit should be based on a daily rental rate of $7.40 per trailer, per day, calculated from the rental rate under the lease. (In other words the monthly lease payment of $90,052. per trailer, multiplied by 12, and divided by 365).

Needless to say, Fruehauf took the position that none of the payments were preferential transfers; that the ninety-day reachback preference period applied to the facts of this case; that the lease was a true lease; and that all of the routinely delinquent lease payments were made in the ordinary course of business dealings between the parties. Alternatively, Fruehauf argued that it was entitled to new value credit for the overall daily rental value of the trailers it provided Southwest after each avoided transfer. It contended that the daily rental rate should be calculated without reference to the rate found in the lease. Its witness Wayne Beatty, vice president of Fleetco Trailer Corporation, testified that the daily rental value for trailers similar to those rented by Southwest, if they had been rented on a *daily* basis rather than under a long-term lease, would have been $16.16 per day. Finally, Fruehauf argued that even though the Trustee could establish that Southwest made six interest payments of $7,590.22 during the year in question, he could not prove when the obligation to make these payments arose, and, therefore, was unable to prove that they were made on account of an antecedent debt.

The case was tried for a day and a half. In his memorandum opinion, the Bankruptcy Court first ruled that the Trustee has satisfied his burden of proof that all the payments made by Southwest to Fruehauf pursuant to the lease agreement were preferential transfers within the meaning of Section 547(b) of the Bankruptcy Code. Next, before turning to the statutory defenses raised by Fruehauf under Section 547(c)(2) (that the transfers are protected from avoidance becaue they were made in the "ordinary course of business . . . of the debtor and the transferee") and Section 547(c)(4) (that, after each avoided preferential transfer, the creditor

gave "new value" to the debtor), he addressed the question of whether the lease at issue was a true lease. This question is significant because, if the lease were a true lease, the obligation to make the lease payments did not arise until the date the rent was due, and any avoidable lease payments would entitle Fruehauf to credit for "new value." The Bankruptcy Court appropriately analyzed the elements of the lease (some of which did suggest that it was a disguised installment sales contract) according to the 14 factors listed in *Consumer Lease Network* v. *Puckett (In re Puckett)*, 60 B.R. 223, 235-239 (Bankr. M.D. Tenn. 1986), *aff'd*, 838 F.2d 470 (6th Cir. 1988). He found the balance weighed in favor of a true lease largely because of the fact that Southwest was not obligated, or "economically compelled," to purchase the trailers at the end of the lease term and because, at the end of the term, the value of the trailers (estimated to be $5,600.) would not in any sense have been negligible.

He also determined, at least partially relying on expert testimony about the practice in the trucking industry, that only those few payments made within 30 days of their due date were made in the "ordinary course of business." In determining the extent of delinquency of each of the payments in question, the Bankruptcy Court followed the Sixth Circuit's rule that the transfer occurs upon delivery of the check from debtor to creditor, and that delivery occurs upon the creditor's actual receipt of the check. *See In re Belknap, Inc.*, 909 F.2d 879, 881 (6th Cir. 1990). With the exception of those checks returned for insufficient funds, the Bankruptcy Court considered the date on which Fruehauf received the checks as the dates on which the payments were made.

Finally, for each of the lease payments to be avoided as preferential, the Bankruptcy Court found Fruehauf was entitled to "new value" credit of $7.40 per day, calculated on the basis of the long-term lease agreement between the parties rather than the rate which might have been charged for a short-term rental of the same trailers.

Based on these findings, judgment was entered against Fruehauf in the amount of $185,009.02. Both parties have appealed.

The Trustee, of course, contends that the judgment should have been much greater. He maintains that the lease was not a true lease but an installment sales contract; that those few payments made within thirty days of their due date were not "ordinary course of business" payments entitled to the exception provided in Section 547(c)(2); that in determining which checks fell within and without the 30 day period, the Bankruptcy Court erred in finding that the transfers occurred when the checks were received rather than when they cleared the bank; and that it erred in finding Fruehauf entitled to new value credit.

Fruehauf, on the other hand, contends that even those lease payments made more than thirty days late, or which were made by checks returned for insufficient funds, were made according to the ordinary course of business between Southwest and Fruehauf and according to ordinary business terms. It argues that the Bankruptcy Judge erred in attempting to determine "industry standards" as part of his inquiry into the ordinary course of business between the parties. Fruehauf also contends that the Bankruptcy Judge committed error in determining the "new value" credit; that he erred in determining that the six interest payments were preferential because the Trustee failed to establish when these payments were due, when the interest accrued, and that they were guaranteed by an insider; that he erred in utilizing the one-year, "insider" preference period; and finally, that he erred in allowing the Trustee's witness Roger Fitch to testify as an expert witness.

This Court is confident that the Bankruptcy Court correctly determined that all 40 payments the Trustee sought to recover, including the six "interest payments," were preferential transfers within the meaning of Section 547(b); and that it correctly determined that the one-year, "insider" preference period applies to this case. The more difficult

questions raised on appeal concern Fruehauf's defenses to liability.

Was it a true lease?

The most important question, of course, is whether or not the lease at issue was a true lease or a disguised installment contract to purchase the trailers. As indicated earlier, the Bankruptcy Court correctly applied the *Puckett* factors to the facts of this case. There is no question that, under the terms of the challenged lease, Southwest was required to provide liability insurance and insurance on the trailers in favor of Fruehauf in an amount high enough to cover the casualty value and the loan balance; that Southwest was required to indemnify Fruehauf for any claims against it by third parties in connection with its use of the trailers (other than manufacturing defects); that Southwest assumed all risk of loss or damage; that Southwest paid for all taxes, repairs, maintenance, cost and expenses for the trailers; that, in the event of loss, Southwest was required to pay all unpaid rent plus the casualty value which was predetermined and which reflected the balance owing on each unit; that Southwest paid for all certificates of title, registration, licenses and permits in connection with the trailers; that, in an "event of default," the total rent payments were immediately due and payable just as they would be pursuant to an acceleration clause under a retail installment contract; and that Southwest was required to provide Fruehauf with quarterly financial statements. Moreover, the amount of each lease payment was derived from a negotiated purchase price plus an interest factor.

On the other hand, the interest applied to the lease was not computed on the basis of the entire sales price but rather that price less the residual value; the interest rate charged (13%) was an internal rate determined and fixed by Fruehauf and was not something negotiated by the parties; the parties negotiating the lease intended it to be a true lease so that Southwest could get a tax deduction for its lease payments;

and the parties only later converted it to a retail installment contract when the investment tax credit advantage to Fruehauf no longer existed. In addition, all certificates of title and registration were in Fruehauf's name; Fruehauf paid for the issuance of titles on the trailers; there was no substantial, non-refundable security deposit; Southwest was not permitted to build up equity in the trailers; and, the fact considered most important to the Bankruptcy Court, at the end of the lease term, Southwest could only have purchased the trailers by paying their fair market value which was estimated at $5,600. per trailer.

The Bankruptcy Court's determination that the lease in question was a true lease is not clearly erroneous. Because this finding appears to involve a mixed question of law and fact, this Court has also re-weighed the *Puckett* factors and made its own, *de novo* determination that it was a true lease.

Are Fruehauf's payments subject to the "ordinary course of business" exception to preference recoveries?

The "ordinary course of business" exception granted in § 547(c)(2) of the Bankruptcy Code, provides that a Trustee may not avoid a preferential transfer if the payment was made (1) in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee; (2) made in the ordinary course of business or financial affairs of the debtor and the transferee; and (3) made according to ordinary business terms. Section 574(c)(2) was designed to protect recurring, customary credit transactions which are incurred and paid in the ordinary course of business of the debtor and the transferee. *In re Fulghum Construction Corp.*, 872 F.2d 739, 743 (6th Cir. 1989). In considering which transactions are "ordinary," courts usually examine several factors such as the timing of the payments, the amount and manner in which the payments were made, and the circumstances under which the payments were made. *See In re Yurika Foods Corp.*, 888 F.2d 42, 45 (6th Cir. 1989).

There is no question that the Bankruptcy Court was correct in finding the first criterion satisfied because Southwest is a trucking corporation which would ordinarily be expected to lease or purchase trailers for its operations and Fruehauf, of course, is a trailer manufacturer which sells and leases trailers. Fruehauf urges that all the payments, even the extremely delinquent ones, also satisfy the second and third criteria in that they were made in the ordinary course of business dealings between the parties and in the trucking industry. Of course, the Bankruptcy Court found that only those payments which were no more than 30 days late satisfied these two requirements.

In making this determination, the Bankruptcy Court examined the timing of the payments to see if they were consistent with the prior course of dealings between the parties. He found that the lease payments made during the four months of transactions prior to the preference period were from five to 31 days late but none were returned for insufficient funds. The lease payments made thereafter ranged from four to 68 days late and 17 checks were returned for insufficient funds. The great majority of the payments made during the preference period were more delinquent than those made prior to it. Moreover, the evidence showed that Furehauf was not satisfied with Southwest's sloppy payment pattern and, in March of 1987, began to pressure Southwest to make more timely payments.

The Bankruptcy Court also considered evidence of the standard practice in the trucking industry and concluded that it was not ordinary for accounts to run more than 30 days past due. In other words, he found that very delinquent payments could not be said to meet the second and third criteria — that they were paid in the ordinary course of business and under ordinary business terms.

Fruehauf argues that the Bankruptcy Court erred in considering industry standards in examining the ordinary course of business defense and should have focussed its inquiry entirely on the ordinary business dealings of the particular

debtor and creditor in question. Moreover, on the basis of the Sixth Circuit's view of the purpose of Section 547(c)(2), as discussed in *In re Yurika Foods Corp.* and *In re Fulghum Construction Corp.*, the section was designed to encourage creditors to continue credit dealings with troubled debtors in order to forestall bankruptcy rather than encourage it. The real issue should be whether or not the creditor took some unusual action to require a debtor to make payments on a more timely basis during the preference period than was required before it so that the creditor would obtain more favorable treatment form the insolvent debtor than other creditors. Fruehauf suggests that the fact that it continued to accept late payments when Southwest was clearly in financial difficulty should help rather than hurt its position in this preference action. This Court agrees.

The Bankruptcy Court's determination that those payments more than 30 days late were made outside the ordinary course of business is a factual determination which should not be set aside unless clearly erroneous. *See In re Yurika Foods Corp.*, 888 F.2d at 45. Nonetheless, this Court is convinced that clear error has occurred with regard to this aspect of the Bankruptcy Court's rulings.

There is nothing in the facts of this case which suggests that an examination of industry practices was warranted. *See In re Yurika Foods Corp.*, at 45. Without that testimony, there is very little reason to select a 30-day period to determine which payments fall outside the protection of the "ordinary course of business" defense. In addition, there is no evidence that Fruehauf made any effort to declare the lease in default or protect its position vis-a-vis other creditors before March of 1987, when Fruehauf first began to pressure Southwest to make more timely payments. When the Court focusses entirely on the payment pattern established between the parties, three payments made in April of 1987 stand out from all the rest by being only 4, 5, and 8 days overdue. It is only these three remarkably prompt payments which contrast with the gradually more delinquent pattern of business dealings between the parties and suggest that, by that time, Fruehauf

was indeed changing its collection practice to better its position.

In this Court's opinion, only these three payments indicate that the course of business dealings between the parties had suddenly altered; only these three deviate from the ordinary course of business dealings between the parties; and only these three preferential payments may be avoided by the Trustee. All the other payments appear to qualify for the affirmative defense provided by Section 574(c)(2) to protect recurring, customary credit transactions.

When were the payments made?

All of the lease payments were made by check. The Trustee insists that the dates on which the checks cleared the bank should be used by the court to determine the dates on which payments were made. However, the Bankruptcy Court, as indicated earlier, followed the rule of *In re Balknap, Inc., supra*, that each transfer occurred upon Southwest's delivery and Fruehauf's actual receipt of each check, unless the check was later returned for insufficient funds. This Court is confident that the Bankruptcy Court took the right approach.

Did the Bankruptcy Court err in awarding Fruehauf "new value" credit or in the way it calculated this "new value"?

Under a lease, a new debt is incurred each month that the lessee continues to use the leased property and the lessee becomes obligated in that month to pay for such use. If payment is not made on time, and the lessee continues to use the property, the lessor is deemed to have given it "new value." Section 547(c)(4) of the Bankruptcy Code provides that the trustee may not avoid an otherwise preferential transfer to or for the benefit of a creditor "to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor — (A) not secured by an otherwise unavoidable security interest; and (B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor." Based upon his finding that

the lease in question was a true lease, the Bankruptcy Court correctly determined that Fruehauf gave Southwest new value when it allowed Southwest to use the trailers after a preferential lease payment was made and that this new value was unsecured. He determined the amount of new value credit on the basis of the daily rental rate for each trailer calculated from the long-term lease agreement itself rather than the short-term usage rates urged upon him by Fruehauf. While Fruehauf contests the rate used, and the formula by which the parties calculated the credits, this Court is satisfied that both are entirely appropriate. Neither the rate of credit nor the formula by which the parties calculated the previous judgment will be disturbed.

Did the Bankruptcy Court err in allowing Mr. Robert Fitch to testify as an expert?

In bringing this adversary proceeding, the Trustee had the initial burden of proving that during the one year preference period, Southwest was insolvent and that the payments it made to Fruehauf allowed this creditor to receive more than it would have received in a Chapter 7 liquidation. 11 U.S.C. § 547(b)(5)(A). The Trustee relied upon the "liquidation analysis" testimony of Mr. Robert Fitch, a certified public accountant, to establish these essential elements of his case. In pretrial interrogatories, Mr. Fitch had been identified as a fact witness but not as an expert. The trustee had not, therefore, supplied Fruehauf a Rule 26 statement of the subject matter on which he was expected to testify, the substance of and grounds for his opinions, etc.

At the start of trial, when Fruehauf invoked the rule of sequestration, it objected to Mr Fitch's continued presence in the courtroom. The Trustee made the following representation to the Court:

> Mr. Fitch will be testifying what he found in books and records of Southwest, but absent that, he is not a factual issue that's gonna dispute some fact that may have happened or may not have happened.

Mr. Fitch was allowed to remain in the courtroom. When he took the stand to testify, and the Trustee attempted to qualify him as an expert, Fruehauf objected on the ground that Fitch had not been identified as an expert prior to trial and that it had not been provided with a Rule 26 summation of his anticipated testimony. The Bankruptcy Court allowed him to testify as an expert.

Furehauf claims extreme prejudice and points out that, without Mr. Fitch's testimony, the Trustee would not have been able to establish the basic elements of a preference action.

The Trustee denies that Fruehauf was prejudiced by this mistake. He points out that Fruehauf took Mr. Fitch's deposition prior to trial and also had the benefit of answers to interrogatories in which the Trusee had identified Fitch as the person who had knowledge of Southwest's insolvency and the fact that Fruehauf received more from Southwest than it would have if the case were a Chapter 7 proceeding. The Trustee had even provided Fruehauf with a copy of Mr. Fitch's liquidation analysis prior to trial.

This court does not believe the Bankruptcy Court committed reversible error in allowing Mr. Fitch's expert testimony.

Conclusion

Accordingly, all of the rulings and the findings of the Bankruptcy Court are hereby AFFIRMED except for the determination of which lease payments may be avoided by the Trustee as preferential transfers. The parties are instructed to submit an amended judgment to this Court, within twenty (20) days from the date on this Order, which conforms with this Court's finding that only the three payments on Lease #108-43934, which occurred on April 9, 10, and 13, 1987, are avoidable preferential transfers unprotected by the "ordinary course of business" defense.

ENTER: /s/ THOMAS G. HULL
United States District Judge

IN THE UNITED STATES BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF TENNESSEE

NO. 88-00033
Chapter 7

ADV. NO. 89-0477

IN RE SOUTHWEST EQUIPMENT RENTAL, INC.
d.b.a. SOUTHWEST MOTOR FREIGHT
Debtor

C. KENNETH STILL, TRUSTEE
Plaintiff

v.

FRUEHAUF CORPORATION
Defendant

MEMORANDUM
(Filed March 6, 1991)

This is an action by the plaintiff trustee pursuant to §§ 547(b) and 550 of the Bankruptcy Code to avoid and recover certain alleged preferential transfers made to the defendant within one year of the filing of the debtor's bankruptcy petition. Having considered the evidence presented at the trial together with the briefs filed by the parties, the court now enters its findings of fact and conclusions of law pursuant to Bankruptcy Rule 7052.

This is a core proceeding. 28 U.S.C.A. § 157(b)(2)(F) (West Supp. 1990).

I. Facts.

On January 8, 1988, Southwest Equipment Rental, Inc., d.b.a. Southwest Motor Freight ("Southwest"), a trucking

corporation with its principal place of business in Chattanooga, Tennessee, filed a chapter 11 bankruptcy petition. On March 8, 1988, Southwest's bankruptcy case was converted to a case under chapter 7. Subsequently, the chapter 7 trustee initiated this action to avoid and recover certain alleged preferential transfers made by the debtor to the defendant, Fruehauf Corporation ("Fruehauf"), a trailer manufacturing corporation.

In April of 1986, Southwest contacted Fruehauf for the purpose of obtaining trailers. Fruehauf gave Southwest the option to purchase the trailers under an installment sales contract or to lease the trailers under either a terminal rental adjustment clause ("TRAC") lease or an investment tax credit lease. Southwest chose the investment tax credit lease which allowed Southwest to receive lower rental payments as a result of an investment tax credit available to Fruehauf. The lease, executed on July 30, 1986, was comprised of a master lease and four supplements that covered 100 trailers each.

The lease term was 84 months, or seven years, and all payments were due monthly. The monthly payment per trailer was $225.13 and the initial payment due dates under the four lease supplements were September 5, October 2, November 3, and December 10, 1986, respectively.

The lease rate was based upon a negotiated purchase price of $16,569.50 per trailer less $5,600, which was the trailer's estimated residual value at the end of the lease term. This sum, which was further adjusted through application of the investment tax credit and depreciation, was then amortized over 84 months. The monthly rental payments also included interest of 13% per annum figured on the entire purchase price amount. The interest rate was applied by Fruehauf to pay for its internal cost of funds and was not a negotiated interest rate that was disclosed to the customer.

At the time the lease was negotiated, Fruehauf bought 350 used trailers from Southwest. After the parties agreed on a price for each trailer, Fruehauf, at Southwest's request, agreed to pay an additional amount for each trailer over and above the agreed-upon purchase price to accommodate

Southwest's accounting and financial needs. In return, Southwest agreed to pay higher rental payments on the new leased trailers to cover the increased amount paid for the used trailers. Overall, an overallowance of $475,000 was added to the price of the new trailers which was amortized over the 84-month lease term. This transaction was secured by an investment certificate pledged by Southwest in the amount of $475,000.

The terms of the lease stated that Southwest was responsible for the taxes, insurance, maintenance, and repairs on the trailers. Also, while the lease required that all certificates of title be in Fruehauf's name, Southwest was obligated to pay the expenses of all trailer registrations, permits, licenses, and titles. Fruehauf, however, paid for the issuance of the titles on the trailers. The lease further provided that Southwest bore the risk of loss on the trailers; that upon default, Fruehauf had the right to accelerate all unmatured payments; and that Southwest had to furnish Fruehauf with annual and quarterly financial statements upon request.

Under the terms of the lease, Southwest had the option to purchase the trailers at the conclusion of the lease term for fair market value. Although the plaintiff presented oral testimony from two of Southwest's former officers that Southwest could purchase the trailers at any time for the amount quoted in the lease's casualty schedule, the testimony did not convince the court that Southwest in fact had such a right. At the end of the lease term, the trailers would have had a useful life of three to five years and an appropriate market value, or residual value, of $5,600 per trailer.

William Thiele, Southwest's president, personally guaranteed the lease payments. He testified that although the trailer transaction was governed by a lease agreement, as far as he was concerned, Southwest actually purchased the trailers at the time the lease agreement was executed. Mark Smits, a Fruehauf representative who participated in the lease negotiations, testified that Thiele specifically requested an "off balance sheet" lease so the rental payments could be deducted as an expense on Southwest's income statements.

Smits testified that an "off balance sheet" lease is commonly understood in the industry to mean a true lease. The oral testimony of the witnesses concerning their subjective characterizations of the transaction as being either a true lease or a disguised retail installment contract was not convincing either way.

As noted, the parties had agreed that the lease payments would be reduced by the amout of any investment tax credit Fruehauf received. The lease terms provided, however, that if the investment tax credit became unavailable, the lease payments would be increased accordingly. During the course of the lease, the tax laws were changed eliminating Fruehauf's investment tax credit. As a result, Fruehauf demanded that the monthly lease payments be increased from $225.13 to $247.96 per trailer.

Southwest and Fruehauf disagreed over the amount of increased lease payments and the applicability of the lease term pertaining to the investment tax credit. To resolve their differences and to avoid litigation, Southwest and Fruehauf agreed to terminate their lease arrangement and enter into an installment sales contract on the trailers. The installment sales contract was entered into on May 5, 1987. The monthly payment on each trailer under the installment sales contract was approximately $271.

Southwest made 40 payments pursuant to the lease agreement totalling $464,283.16 to Fruehauf within one year prior to the filing of Southwest's bankruptcy petition. All of the payments were delinquent, 17 checks were issued to replace checks returned for insufficient funds, and another five checks never cleared the bank. Six payments were interest payments of $7,590.22 each.[1]

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[1] These interest payments were described as being interest on a deficiency due under the lease agreement that needed to be paid in order to keep the agreement current pending the substitution of the installment sales contract on May 5, 1987. Fruehauf was entitled to this interest on the unpaid deficiency for a period of time up until the installment sales contract was executed on May 5, 1987.

In a letter dated March 25, 1987, to Fruehauf, which was obviously in response to an earlier contact from Fruehauf, Southwest stated that it understood Fruehauf expected the payments due through April, 1987 to be paid by April 25, 1987, the May payments to be paid by May 14, 1987, the June payments to be paid by June 7, 1987 and the July, 1987 payments to be timely. Subsequently, the lease payments became less delinquent.

The preponderance of the evidence established it is not uncommon for lease payments in the trucking industry to run one to 30 days past due. Even though Southwest's expert witness testified that his trucking company had always made its payments on time, several witnesses for the defendant testified that it is common for companies to make late payments when leasing trailers. Gary Andriotti, the treasurer and comptroller for Interstate Truck Leasing, a truck and trailer leasing company in Albany, Georgia, testified that of the trucking accounts at his firm, 70% are one to 30 days late from time to time and 30% are consistently more than 15 days late. Mark Smits testified that of the common carrier accounts with which he has dealt, those that might be delinquent one to 30 days would be approximately 20 to 25%. Finally, John Morrow, vice president of Associates Commercial Corporation, with 15 years' experience in the financing and leasing of heavy trucks and trailers, testified that from June, 1986 to May, 1987 approximately 20% of the accounts he handled were one to 30 days past due.

The preponderance of the evidence also established, however, that it is not ordinary for lease payments to run from 30 to 60 days past due. Mark Smits testified that only 7 to 10% of the common carrier accounts with which he had dealt had been from 31 to 60 days delinquent. In addition, Johnny Morrow, who had become involved with the Southwest account because of the seriousness of it delinquency, testified that from June, 1986 to May, 1987 only 2 to 3% of the accounts he handled were 30 to 60 days late. Morrow also testified the only 1% of accounts he has handled have bounced checks through the term of the contract.

Witnesses for both Southwest and Fruehauf testified concerning what rental rate should be used in computing new value. Roger Fitch testified that if the lease were a "true" lease and Fruehauf received credit for any new value given Southwest, the trustee would be entitled to recover approximately $181,000 from Fruehauf. Fitch arrived at this figure by using the daily rental rate of the trailers under the lease. He multiplied the amount of the monthly lease payment, $90,052, by 12 to compute a total rent for the year. He then divided that figure by 365 to conclude that the daily rental on the 400 trailers was $2,960.61. This equals $7.40 per trailer per day.

According to the testimony of the defendant's witness, Wayne Beatty, vice president of Fleetco Trailer Corporation, the daily rental value from July, 1986 to May, 1987 for trailers similar to those rented by Southwest, if they had been rented on a daily rental basis rather than under a long-term lease, would have been $16.16 per day.

Neither William Thiele nor Fruehauf are fully secured creditors. William Thiele received no security interest for his personal guarantee of the lease and Fruehauf is an undersecured creditor. As of December, 1986, the difference between what Fruehauf was owed by Southwest and the value of Fruehauf's collateral was approximately $2,300,000.

As of December 31, 1986, Southwest's assets were $45,267,000 and its liabilities were $59,614,000. Southwest's liabilities continued to exceed its assets each day of the year prior to the filing of Southwest's petition in bankruptcy. The bankruptcy estate will not have sufficient funds to pay unsecured creditors in full.

II. Summary of Contentions.

The plaintiff contends Southwest made 40 "lease" payments totalling $464,283.16 to Fruehauf from January, 1987 through June, 1987 that were preferential transfers. The plaintiff contends the lease agreement between Fruehauf and Southwest was actually a disguised retail installment contract

and that all 40 payments by Southwest were preferential payments on account of the antecedent purchase price debt. Alternatively, the plaintiff argues that if the court concludes the lease was a true lease, the lease payments were still preferential in that they were late, were not made in the ordinary course of business, and were not made as contemporaneous exchanges for new value. Finally, the plaintiff asserts that Fruehauf would not be entitled to new value credit under § 547(c)(4), but that if Fruehauf is entitled to such credit, it should be ascertained utilizing a daily rental rate calculated from the rental rate under the lease.

The defendant disputes that the plaintiff proved the transfers were preferential. Also, the defendant contends the lease is a true lease and that the lease payments were made in the ordinary course of Southwest's business and the industry. Alternatively, the defendant contends it is entitled to credit for the overall daily rental value for the use of the trailers it provided Southwest after each avoided transfer. The defendant argues the daily rental rate should be calculated without reference to the rate found in the lease. Finally, the defendant contends that even though the trustee established that six payments of $7,590.22 were interest payments, the trustee failed to show when the obligation to pay these interest payments arose, and, therefore, failed to prove these payments were made on account of an antecedent debt.

III. Discussion.

The first issue to be determined in this case is whether payments made by Southwest to Fruehauf between January, 1987 and June, 1987 pursuant to the lease agreement were preferential transfers. Section 547(b) of the Bankruptcy Code provides:

> (b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property—
>
> (1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made:

(3) made while the debtor was insolvent;

(4) made—

(A) on or within 90 days before the date of the filing of the petition; or

(B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

(5) that enables such creditor to receive more than such creditor would receive if—

(A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

11 U.S.C.A. § 547(b) (West 1979 & Supp. 1990).

The parties do not dispute that Southwest made 40 payments pursuant to the lease agreement totalling $464,283.16 to Fruehauf within one year preceding the filing of Southwest's bankruptcy petition. Except for six interest payments[2], there appears to be no disagreement that

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[2] The defendant contends the trustee failed to show that six interest payments were payments for an antecedent debt because the trustee did not show when the interest had accrued. A debt for interest is incurred when the interest accrues. *DuVoisin* v. *Anderson (In re Southern Indus. Banking Corp.)*, 92 B.R. 297, 304 (Bankr. E.D. Tenn. 1988); *Ford Motor Credit Co.* v. *Ken Gardner Ford Sales (In re Ken Gardner Ford Sales)*, 10 B.R. 632, 648 (Bankr. E.D. Tenn. 1981), *aff'd*, 23 B.R. 743, 747 (E.D. Tenn. 1982); *accord, Iowa Premium Serv. Co.* v. *First Nat'l Bank*, 695 F.2d 1109, 1112

§ 547(b)(2) has been satisfied in that the lease payments — all late — were for or on account of an antecedent debt owed by the debtor before such transfer was made. Likewise, the plaintiff has satisfied § 547(b)(1) and § 547(b)(4) of the preference elements since all the payments made by Southwest to Fruehauf within the one-year period benefitted Thiele, an insider guarantor of the lease obligations. *See Ray* v. *City Bank and Trust Co. (In re C-L Cartage Co.)*, 899 F.2d 1490, 1494 (6th Cir. 1990); *Levit* v. *Ingersoll Rand Financial Corp.*, 874 F.2d 1186, 1201 (7th Cir. 1989); *Lowrey* v. *First Nat'l Bank (In re Robinson Bros. Drilling)*, 97 B.R. 77, 83 (W.D. Okla. 1988) *aff'd*, 892 F.2d 850 (10th Cir. 1989).

Section 547(b)(3) requires that in order for a transfer to be preferential it must be made while the debtor is insolvent. "An entity is insolvent if its debts are greater than its assets, at a fair valuation, exclusive of property exempted or fraudulently transferred." *Crews* v. *Truver (In re Flight Management)*, 99 B.R. 477, 478 (Bankr. M.D. Fla. 1989); *see also* 11 U.S.C.A. § 101(31) (West Supp. 1990). The evidence established that at the time the transfers were made, the debtor was insolvent.

Section 547(b)(5) requires that in order for a transfer to be preferential it must enable a creditor to receive more than the creditor would have received in a chapter 7 liquidation and the disputed transfer had not been made. William Thiele received no security interest for his personal guarantee of the lease and Fruehauf is undersecured in an amount exceeding the transfers at issue. There will not be sufficient funds in the estate to pay unsecured creditors. Therefore, each of the lease payments at issue reduced Thiele's potential liability to

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(8th Cir. 1982). Although the trustee did not show when the obligation to make the interest payments had accrued, the obligation to make all payments under the lease had certainly accrued by the time Southwest terminated the lease and entered into the installment sales contract on May 5, 1987. Since the six interest payments were all made subsequent to that date, they were made for or on account of an antecedent debt.

Fruehauf under the guarantee, and enabled Thiele to receive more than he would have received in a chapter 7 liquidation if the payments had not been made. *See Palmer Clay Products Co.* v. *Brown*, 297 U.S 227, 229 (1936) (if distribution in bankruptcy case is less than 100%, any payment to unsecured creditor during the preference period will enable that creditor to receive more than it would have received in liquidation had the payment not been made); *Ray* v. *City Bank and Trust Co. (In re C-L Cartage Co.)*, 899 F.2d at 1493; *Levit* v. *Ingersoll Rand Financial Corp.*, 874 F.2d at 1199-1200.

The trustee successfully proved all the elements of § 547(b) with respect to the transfers at issue in this case. Next, the court must decide whether the defendant's proof established either a § 547(c)(2) or § 547(c)(4) defense to the trustee's action. Before turning to these statutory defenses, however, it is appropriate at this point to ascertain whether the lease at issue is a true lease or a disguised retail installment contract. If a true lease, the obligation to pay the lease payments would not have arisen until the date the rent was due and late lease payments might entitle the defendant to a credit for new value. Contrariwise, if the lease is a disguised installment sales contract, it might prove more difficult for the defendant to establish an ordinary course of business defense and the defendant would not be entitled to any new value credit.

In *Consumer Lease Network* v. *Puckett (In re Puckett)*, 60 B.R. 223, 235-239 (Bankr. M.D. Tenn. 1986), *aff'd*, 838 F.2d 470 (6th Cir. 1988), the bankruptcy court listed 14 factors it considered in determining whether or not a lease was a true lease. Those factors are: (1) whether the parties intended the lease to be a sale with financing; (2) whether the seller/lessor was a financier; (3) whether the customer provided insurance and bore the risk of loss; (4) whether the customer provided maintenance and repairs for the goods leased; (5) whether the customer paid the taxes on the goods leased; (6) whether the default provisions were similar to those contained in a secured sale agreement; (7) whether there was a substantial nonrefundable security deposit; (8) whether the seller/lessor pur-

chased the goods for the customer from a designated third party; (9) whether the monthly payment far exceeded the amount that would be necessary to compensate the seller/lessor for the loss of value over the lease term due to aging, wear and obsolescence; (10) whether the seller/lessor disclaimed all warranties; (11) whether the customer acquired equity in the goods; (12) whether the goods had a useful life to the customer in excess of their economic value to the seller/lessor; (13) whether the customer was permitted to pay a deferral charge; and (14) the sophistication and bargaining power of the parties. *Id.*

Not surprisingly, the lease transaction in the instant case contains characteristics typically found in both an installment sales contract and a true lease. On the one hand, facts supporting an inference that the transaction is more akin to an installment sales contract include: (1) the lease payments were derived from a negotiated purchase price plus an interest factor; (2) the lease was converted to an installment sales contract within nine months of the execution of the lease; (3) the lease required that Southwest pay the taxes on the trailers and provide insurance, maintenance, and repairs; (4) the lease required Southwest to pay for all trailer registrations, permits, licenses, and titles; (5) the risk of loss was placed on Southwest; and (6) upon default, Fruehauf had the right to accelerate unmatured payments. On the other hand, facts supporting an inference that the transaction is a true lease include: (1) Southwest chose the investment tax credit lease over an installment sales contract because the monthly payments were lower due to application of the investment tax credit and Southwest wanted an "off balance sheet" lease so that lease payments could be reported as current expenses; (2) the interest rate utilized by Fruehauf to calculate a monthly lease payment was an internal rate applied by Fruehauf to cover its internal cost of funds and not a negotiated interest rate on a sale; (3) the lease agreement was converted to an installment sales contract to settle a dispute between Southwest and Fruehauf over increased monthly lease payments that

went into effect under the terms of the lease when Fruehauf lost its investment tax credit; (4) even with the loss of the investment tax credit, the lease payments would have continued to have been lower than payments under the installment sales contract; (5) although Fruehauf finances trailer purchases, it also leases trailers; (6) all certificates of title and registrations were to be in Fruehauf's name; (7) Fruehauf paid for the issuance of titles on the trailers; (8) there was no substantial nonrefundable security deposit; (9) the trailers were not selected from an independent third party; (10) Fruehauf did not disclaim all warranties in the lease; (11) Southwest was not permitted to build up equity in the trailers; (12) there was no charge which permitted Southwest to defer payment under the lease; (13) the parties to the transaction were sophisticated and knowledgeable; and most importantly, (14) at the end of the lease term, Southwest could purchase the trailers only by paying market value which would have been approximately $5,600 per trailer.

An agreement may be a true lease even though it contains a number of provisions indicative of an installment sales contract. In *Jahn* v. *M. W. Kellogg Co. (In re Celeryvale Transp.)*, 822 F.2d 16, 19 (6th Cir. 1987), the Sixth Circuit Court of Appeals affirmed a lower court's finding that an investment tax credit lease for refrigerated trailers was a true lease despite the fact the lease arrangement had a number of characteristics common to an installment sales contract. The terms of the lease required the lessee to provide liability and property damage insurance on the trailers, to indemnify the lessor for claims arising out of the use of the trailers, to pay all taxes, to bear the risk of loss on the trailers, and to pay all maintenance costs. In addition, the benefits of the investment tax credit were passed through to the lessee, the lessee agreed to pay the cost of obtaining the title certificates, and the profit on the lease was about the same as the profit on a secured sale.

In affirming the lower court's decision, the appeals court noted that although the debtor lessee had undertaken obliga-

tions under the lease similar to obligations in a conditional sales contract, such obligations frequently appear in true leases and they did not prove the lessor intended to give full control and ownership of the trailers to the debtor. *Jahn* v. *Kellogg Co. (In re Celeryvale Transp.)*, 822 F.2d at 19; *See also Fruehauf Corp.* v. *International Plastics (In re International Plastics)*, 18 B.R. 583, 588 (Bankr. Kan. 1982). Although each case obviously turns on its own facts, the court did highlight the most important factor one should consider in determining whether a lease is a true lease or a disguised installment sales contract. According to the court:

> [t]he most illustrative test to distinguish between a true lease and a lease intended as security is whether the 'lessee' is 'obligated to accept and pay for the property or [instead] is obligated only to return on account for the property according to the terms of the lease from which he may be excused if he exercises his privilege of purchasing it.' If the former is true, then the lease is a security instrument in a disguised sale; if the latter, then a true lease exists.

Jahn v. *M. W. Kellogg Co. (In re Celeryvale Transp.)*, 822 F.2d at 18, (quoting *United States Fidelity and Guaranty Co.* v. *Thompson & Green Machinery Co.*, 568 S.W.2d 821, 825 (Tenn. 1978)).

In the instant case, Southwest was not obligated or "economically compelled" to purchase the trailers at the end of the lease term. The terms of the lease gave Southwest the option to purchase the trailers for fair market value and the evidence indicates the fair market value of the trailers at the conclusion of the lease term would not have been negligible since the trailers would still have had a useful life of three to five years and a residual value of $5,600 per trailer. Although each side can legitimately claim a number of the *Puckett* factors support their respective positions concerning the character of the lease in this case, the fact that the purchase

option was not nominal and Southwest was not "economically compelled" to purchase the trailers at the expiration of the lease tips the scales in favor of a conclusion that the lease was a true lease.

Next, the court must decide whether any or all of the lease payments made after the monthly payment date under the lease are protected from avoidance through application of § 547(c)(2) of the Bankruptcy Code. Section 547(c)(2) provides:

> (c) The trustee may not avoid under this section a transfer—
>
> (2) to the extent that such transfer was—
>
> (A) in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee;
>
> (B) made in the ordinary course of business or financial affairs of the debtor and the transferee; and
>
> (C) made according to ordinary business terms.

11 U.S.C.A. § 547(c)(2) (West Supp. 1990).

Section 547(c)(2) was designed to " 'protect recurring, customary credit transactions which are incurred and paid in the ordinary course of business of the Debtor and the transferee.' " *Waldschmidt* v. *Ranier (In re Fulghum Constr. Corp.)*, 872 F.2d 739, 743 (6th Cir. 1989) (quoting *In re Energy Co-op, Inc.*, 832 F.2d 997, 1004 (7th Cir. 1987)). The congressional purpose in enacting § 547(c)(2) was "to leave undisturbed normal financial relations, because it does not detract from the general policy of the preference section to discourage unusual action by either the debtor or his creditors during the debtor's slide into bankruptcy." *Waldschmidt* v. *Ranier (In re Fulghum Constr. Corp.)*, 872 F.2d at 743

(quoting S. Rep. No. 989, 95th Cong., 2d Sess. 88, *reprinted in* 1978 U.S. Code Cong. & Admin. News 5787, 5874). "In considering which transactions are ordinary, courts examine several factors, including timing, the amount and manner a transaction was paid and the circumstances under which the transfer was made." *Yurika Foods Corp.* v. *United Parcel Serv. (In re Yurika Foods Corp.)*, 888 F.2d 42, 45 (6th Cir. 1989) (citing *Newton* v. *Ed's Supply Co. (In re White)*, 58 B.R. 266 (Bankr. E.D. Tenn. 1986)).

Section 547(c)(2)(A) requires that the defendant prove each transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee. In the instant case, Southwest is a trucking corporation which needed to lease or purchase trailers periodically for its operations and Fruehauf is a trailer manufacturer which sells and leases trailers. Southwest obtained trailers for its operations by entering into the lease agreement with Fruehauf. The lease payments at issue were made pursuant to the lease. Hence, the transfers were in payment of a debt incurred by Southwest in the ordinary course of business or financial affairs of Southwest and Fruehauf.

Sections 547(c)(2)(B) and (C) require the defendant to prove the payments were made in the ordinary course of business of financial affairs of the debtor and the transferee and according to ordinary business terms. Although in this case all the lease payments were made after the due dates in the lease, courts have held that late payments may be within the ordinary course of business exception of § 547(c)(2) if they are consistent with the prior course of dealings between the parties. *See Morris* v. *Kansas Drywall Supply Co. (In re Classic Drywall)*, 121 B.R. 69, 76-77 (Kan. 1990); *Yurika Foods Corp.* v. *United Parcel Serv. (In re Yurika)*, 888 F.2d at 44; *Waldschmidt* v. *Ranier (In re Pulghum Constr. Corp.)*, 872 F.2d at 743; *In re Xonics Imaging*, 837 F.2d 763, 766 (7th Cir. 1989); *Newton* v. *Ed's Supply Co. (In re White)*, 58 B.R. 266, 270 (Bankr. E.D. Tenn. 1986).

In determining the extent of the delinquency of payments, the court must decide when the lease payments were made.

All the lease payments at issue were made by check. The trustee asserts that the dates on which the checks cleared the bank should be considered the dates the payments were made. However, for the purpose of deciding what constitutes a transfer under § 547(b), the sixth circuit has held that "in the case of check transactions, with the exception of post-dated checks, transfer occurs upon the delivery of the check, from debtor or creditor, and that delivery occurs upon the creditor's actual receipt of the check." *Official Unsecured Creditors' Committee of Belknap* v. *Shaler Corp. (In re Belknap)*, 909 F.2d 879, 881 (6th Cir. 1990). in addition, "the check must be presented for payment within 'the 30-day period deemed reasonable under the U.C.C.' and honored upon presentment in order for the delivery date to be considered the time of transfer." *Id.* at 884.

At trial, the trustee sought to prove that Southwest habitually asked Fruehauf to hold checks for future deposit. In this regard, the trustee introduced a letter dated March 25, 1987, which contained six lease payment checks and requested that Fruehauf deposit the checks on stated dates between March 26 and March 31, 1987. There was no showing that any of the checks were post-dated. The trustee's evidence was insufficient to convince the court that the majority of checks were held by Fruehauf at Southwest's request or that it should depart from the general rule that in check transactions the transfer occurs upon receipt of the check by the creditor. Therefore, except for checks returned for insufficient funds, the dates on which Fruehauf received the checks are the dates the payments were made.

Using the payment due dates under each of the lease supplements, the court finds the lease payments made prior to the preference period (September, 1986 — December, 1986) were from five to 31 days late, and the lease payments made thereafter during the preference period were from four to 68 days late. The following list sets forth the history of lease payments made by Southwest to Fruehauf between September, 1986 and April 1987:

Lease #108-43934 (100 Fruehauf Trailers)

Date Paid	Due Date	Days Late	Amount Paid
09-26-86	09-05-86	21	$22,513.00
10-31-86	10-05-86	26	22,513.00
12-04-86	11-05-86	29	22,513.00
01-09-87	12-05-86	35	22,513.00
02-05-87	11-05-86	—	(22,513.00)
02-11-87	12-05-86	68	22,513.00
02-13-87	01-05-87	39	10,005.70
02-16-87	01-05-87	42	10,005.77
02-17-87	01-05-87	43	2,501.46
03-11-87	02-05-87	34	10,005.78
03-12-87	02-05-87	35	10,005.78
03-13-87	02-05-87	36	2,501.46
03-26-87	03-05-87	21	22,513.00
04-09-87	04-05-87	4	9,005.20
04-10-87	04-05-87	5	9,005.20
04-13-87	04-05-87	8	4,502.60

Lease #108-43919 (100 Fruehauf Trailers)

Date Paid	Due Date	Days Late	Amount Paid
10-31-86	10-02-86	29	$22,513.00
12-02-86	11-02-86	30	22,513.00
01-12-87	12-02-86	41	22,513.00
02-24-87	01-02-87	53	12,507.22
02-25-87	01-02-87	54	10,005.78
03-13-87	02-02-87	39	7.504.32
03-16-87	02-02-87	42	10,005.78
03-17-87	02-02-87	43	5,002.90
03-27-87	03-02-87	25	22,513.00
04-14-87	04-02-87	12	4,502.60
04-14-87	04-02-87	12	9,005.20
04-15-87	04-02-87	13	9,005.20

Lease #108-44035 (100 Fruehauf Trailers)

Date Paid	Due Date	Days Late	Amount Paid
12-04-86	11-03-86	31	$22,513.00
01-14-87	12-03-86	42	22,513.00
02-19-87	01-03-87	47	5,002.87
02-20-87	01-03-87	48	5,002.87
02-23-87	01-03-87	51	12,507.26
03-17-87	02-03-87	42	5,002.88
03-18-87	02-03-87	43	10,005.78
03-19-87	02-03-87	44	7,504.34
03-30-87	03-03-87	27	22,513.00
04-16-87	04-03-87	13	9,005.20
04-20-87	04-03-87	17	13,507.80

Lease #108-45288 (100 Fruehauf Trailers)

Date Paid	Due Date	Days Late	Amount Paid
12-05-86	12-10-86	4	$22,513.00
02-17-87	01-10-87	38	7,504.31
02-18-87	01-10-87	39	10,005.78
02-19-87	01-10-87	40	5,002.91
03-19-87	02-10-87	37	2,501.44
03-20-87	02-10-87	38	10,005.78
03-23-87	02-10-87	41	10,005.78
03-31-87	03-10-87	21	22,513.00
04-20-87	04-10-87	10	4,502.60
04-21-87	04-10-87	11	9,005.20
04-23-87	04-10-87	13	9,005.20

When payments made during the preference period are more delinquent than payments made during the parties' prior course of dealing, this is a good indication that the payments are not made within the ordinary course of business. For instance, in *Carlson* v. *Hughes (In re Aldridge)*, 94 B.R. 589, 593 (Bankr. W.D. Mo. 1988), the court held payments made during the preference period to a creditor on

an installment note were not within the ordinary course of business exception because the note did not allow a grace period, and the late payments during the preference period were substantially later on the average than late payments made prior to the preference period. *In Jensen* v. *Raymond Bldg. Supply Corp. (In re Homes of Port Charlotte)*, 109 B.R. 489, 491 (Bankr. M.D. Fla. 1990), the court found late payments made prior to the preference period were from 28 to 76 days late, but during the preference period late payments were made from 63 to 109 days late. The court stated "[e]ven though the payments prior to the preference period were generally later than the invoice terms, clearly, the dealings between the parties changed during the preference period." *Id.* The court held that "the dealings between the parties during the preference period were not in the ordinary course of business and that, therefore, any payment made beyond 76 days from the date of the invoice is a preference and outside the protection of § 547(c)(2)." *Id.*, *see also*, *Global Distrib. Network* v. *Star Expansion Co. (In re Global Distrib. Network)*, 103 B.R. 949, 952-953 (Bankr. N.D. Ill. 1989); *Marathon Oil Co.* v. *Flatau (In re Craig Oil Co.)*, 785 F.2d at 1568; *Ewald Bros., Inc.* v. *Kraft, Inc. (In re Ewald Bros., Inc.)*, 45 B.R. 52, 57 (Bankr. D. Minn. 1984) (prior course of dealing in which many payments had been one or two days late did not establish that the ordinary course of the parties' business included payments made nine days after due date).

In the instant case, the majority of the lease payments during the preference period were over 31 days late. Although Fruehauf contends these late payments were made within the ordinary course of business, the evidence at trial showed that sometime prior to March 25, 1987 Fruehauf began to pressure Southwest to make timely payments. Fruehauf notified Southwest it expected the payments due through April, 1987 to be made by April 25th, the May payments to be made by May 15, the June payments to be made by June 7, and the July payments to be on time. The April payments were all made prior to April 25, 1987.

Not only were the majority of the lease payments made later during the preferential period than previously, but 17 checks were issued to replace checks returned for insufficient funds and another five checks never cleared the bank. "Receipt of checks later returned for 'not sufficient funds' ("NSF") catapults payment outside the ordinary course of business sanctuary by effecting an extension of credit not intended by the parties." *See DuVoisin* v. *Anderson (In re Southern Indus. Banking Corp.)*, 92 B.R. at 305; *Ewald Bros., Inc.* v. *Kraft, Inc. (In re Ewald Bros., Inc.)*, 45 B.R. at 57-58 (Bankr. D. Minn. 1984). In the instant case, the defendant has presented no evidence that any lease payment checks made prior to the preference period were returned for insufficient funds. *See DuVoisin* v. *Anderson (In re Southern Indus. Banking Corp.)*, 92 B.R. at 306; *Ewald Bros., Inc.* v. *Kraft, Inc. (In re Ewald Bros., Inc.)*, 45 B.R. at 58, n. 14.

The following chart shows which checks were returned because of insufficient funds:

Check Number	Replacement Check No.	Amount
132882	137948	$22,513.00
—	138194	22,513.00
140104	140912	10,005.78
140105	140907	10,005.78
140959	141654; 142590	22,513.00
140961	141655; 142737	22,513.00
141651	———; 142737	9,005.20
141649	142663; 200382	9,005.20
141652	142786	9,005.20
143370	200381	7,590.22
143371	200378	7,590.24
143372	200379	7,590.22
143374	200380	7,590.22

The proof at trial also demonstrated that while it is ordinary in the trucking industry for common carrier accounts to run one to 30 days past due, it is not ordinary for these accounts to run between 30 and 60 days past due. In fact, the

defendant's expert, John Morrow, testified he became involved with the Southwest account because of the seriousness of its delinquency.

The court concludes the lease payments made within the preference period which were over 30 days late or which were made by checks returned for insufficient funds were not made according to the ordinary course of business of Southwest and Fruehauf or according to ordinary business terms. Those payments made 30 days late or less were consistent with the parties' prior course of dealings and according to ordinary business terms and, thus, fall within the § 547(c)(2) exception.[3]

Fruehauf contends it gave Southwest new value under § 547(c)(4) of the Bankruptcy Code for which it should receive credit against prior avoided transfers. Section 547(c)(4) provides:

> (c) The trustee may not avoid under this section a transfer—
>
> (4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor—
>
> (A) not secured by an otherwise unavoidable security interest; and
>
> (B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor.

11 U.S.C.A. § 547(c)(4) (West 1979).

Under § 547(c)(4), the defendant must meet three requirements: the creditor must have extended new value after

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[3] The six interest payments made after May 5, 1987, were all preferential transfers. *See* n.2. Although the defendant established a § 547(c)(2) defense with regard to some of the late lease payments, this defense was not established with regard to the interest payments.

receiving the preference; the new value must have been unsecure; and on account of the new value the debtor must not have made an otherwise unavoidable transfer to or for the benefit of the creditor. *See also Young* v. *Peter J. Saker, Inc. (In re Paula Saker & Co.)*, 53 B.R. 630, 633-634 (Bankr. S.D.N.Y. 1985); Kirksey, *A Simplified Approach To Preference Calculations—Section 547(c)(4) Of The Bankruptcy Reform Act Of 1978 And The "At Risk" Rule*, 61 Am. Bank. L. J. 255, 261-262 (1987). Credit given for unpaid rent constitutes an advance for purposes of determining whether new value has been given under § 547(c)(4). *Young* v. *Saker (In re Paula Saker & Co.)*, 53 B.R. at 634; *Thomas W. Garland, Inc.* v. *Nooney Co. (In re Thomas W. Garland, Inc.)*, 28 B.R. 87, 89 (Bankr. E.D. Mo. 1983). Advances of new value are to be offset against prior preferential transfers. *See, e.g., Waldschmidt* v. *Ranier (In re Fulghum Constr. Corp.)*, 706 F.2d 171, 173 (6th Cir. 1983) ("net result rule" no longer authorized under the Bankruptcy Code); *Waldschmidt* v. *Ranier (In re Fulghum Constr. Corp.)*, 45 B.R. at 117.

The trustee asserts Fruehauf is not entitled to receive credit for giving new value since the lease is similar in substance to an installment sales agreement. The court has found, however, that the lease is a true lease and thus Fruehauf — like other lessors in long-term lease arrangements — should not be precluded from receiving the appropriate amount of new value credit. *See, e.g., Garland* v. *Nooney Co. (In re Thomas W. Garland)*, 28 B.R. at 89. Fruehauf gave Southwest new value when it allowed Southwest to use the trailers after a preferential lease payment was made. This new value was unsecured. Fruehauf is entitled to new value credit, however, only for the new value advanced after which Southwest did not make a subsequent unavoidable transfer to Fruehauf.

In determining how much new value a creditor has advanced, courts have consistently used the contract cost of the goods or services provided. *See, e.g., Kroh Bros. Dev. Co.* v. *Aoki Landscape Maintenance (In re Kroh Bros. Dev. Co.)* 104

B.R. 182, 194 (Bankr. W.D. Mo. 1989); *Remes* v. *Yeomans (In re Quality Plastics)*, 41 B.R. at 243 (appropriate measure of new value extended by the lessor was amount at which the machines were rented under equipment leases rather than the productivity of the machines): *Valley Candle Mfg. Co.* v. *Stonitsch (In re Isis Foods, Inc.)*, 39 B.R. 645, 647 (W.D. Mo. 1984). In this case, the daily rental rate for each trailer calculated on the basis of the lease agreement is $7.40. This figure is the appropriate rate for determining new value since the trailers were being leased at the rates under the long-term lease agreement between Fruehauf and Southwest and not at rates for short-term usage.

The parties are instructed to submit a judgment in accordance with the findings and conclusions stated herein within 20 days of the entry of this memorandum. If the parties are unable to agree to the form of the judgment, they are to submit separate judgments together with a memorandum setting forth their calculations of the judgment amount.

/s/ JOHN C. COOK
United States Bankruptcy Judge